China's Global Energy Quest

China's Growing Pipeline into Canada

Cindy Hurst August 11th 2008

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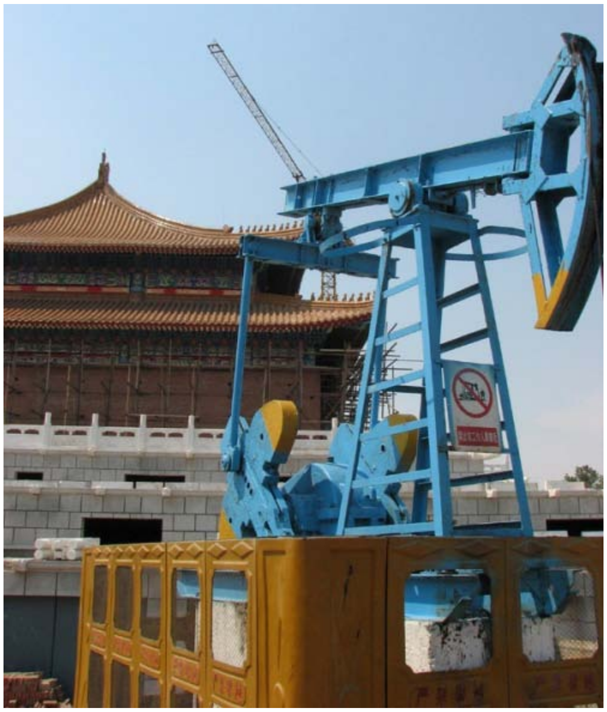

China's relentless quest for energy has brought it to the U.S. neighboring country of Canada.

Fifteen years ago, China did not import any oil at all. Today, however, the Asian country is the world's second largest consumer of oil. In 2004, oil imports to China are said to have increased by 37 %, which contributed to soaring oil prices around the world.

In 2007, China consumed an average of 7.5 million barrels per day (mbd) of oil. That amount is projected to increase to approximately 13.6 mbd by 2025. That same year, China's production level is expected to be approximately 3.7 mbd, which will require the country to have a net import of at least 9.9 mbd.

The significance of China extending its pursuit of oil into Canada is that Canada has been the number one source of U.S. oil imports for the past decade. According to figures released by the Energy Information Administration, in 2006 Canada produced an average of 3.288 mbd of oil. Of this, an average of just over 2.353 mbd, or 72 % of the oil produced, has been exported to the U.S.

Within the past three years, in an effort to increase its own energy security, China has begun flexing its muscles to strike various deals with Canada to win access to some of the most prized oil reserves in North America. In April 2005, China National Offshore Oil Corporation (CNOOC), through its wholly owned subsidiary CNOOC Belgium BVBA, signed an agreement with MEG Energy Corp., a Canada-based company, to buy 16.67% of MEG for $135 million. MEG has the rights to an oil sands lease in a 52-section (32,900 acres) oil sands block that is believed to contain 2 billion barrels of recoverable oil. This acquisition is expected to help pave the way for further investment into Canada's huge oil sands resources. In another deal, Sinopec has acquired 40 % of the Northern Lights Oil Sands Project in Alberta, where production is expected to begin sometime in 2010. Then, last year China National Petroleum Corporation (CNPC) won exploration rights for a 260-acre tract in Alberta.

China has also been concentrating on creating export routes from Canada. In another business transaction, PetroChina Co. Ltd. and Enbridge Inc., Canada's number two pipeline company, signed a memorandum of understanding to cooperate on the development of the Gateway pipeline which is expected to transport approximately 400,000 bpd of oil produced from the Alberta oil sands from Edmonton to a port on the west coast of British Columbia, where it can then be shipped via tanker to China as well as other Asia-Pacific markets and California. China

will possibly sign up for as much as half of the pipeline's capacity of (200,000 bpd), while Enbridge will broker the supply deals between PetroChina and oil sands producers.

In 2003, the U.S. bought over 50% of Canada's oil production, which equates to 1.5 mbd or 553,000,000 barrels for the year. That same year China imported a mere 376,000 barrels the entire year, most likely in one or two small shipments during the winter.

Although China's involvement may seem insignificant thus far, further encroachment into neighboring Canada's oil supply could potentially cause uneasiness between Canada and the U.S., which have shared a smooth energy relationship since the 1970s. Historically almost all of Canada's exported oil had been sent via a pipeline heading south. Now China is busy striking up deals with Canadian companies that could ultimately cause it to begin gaining market share. Like any capitalistic business, Canadian firms would not likely reject offers made by the Chinese simply to protect U.S. imports.

Additionally, Canada is capitalizing on China's growth in other areas as well. For example, economic growth in the U.S. has been slowing. As a result of this slowing, the U.S. is not importing as much from Canada. This would have a negative impact on the Canadian economy if it weren't for China offsetting this with its purchases of metallic minerals, machinery and electrical equipment exports. While exports to the U.S., which account for 64 % of Canada's exports, drop in areas such as the forestry sector, China is picking up the slack in other areas. In April 2005, the Canadian government released its International Policy Statement which stated, "Internationally, we will secure and enhance Canada's place in the U.S. market, anchoring our position in a globally competitive North American economy, and further develop our trade and investment links with new economic powerhouses such as China, India and Brazil."

With a newfound interest in expanding its economic reach to further its exports, coupled with the slowing economies of the U.S. and Japan, Canada could easily feel justified in increasing its oil supplies to China. Should China become aggressive enough, it would be plausible to cause the U.S. to lose part of its market share. This is not likely to happen any time soon, however. There are a number of hurdles China first needs to overcome. Long-term contracts to sell oil to the Chinese need to be signed. Supply deals with other potential shippers need to be signed. Canada must figure out which port will best support supertankers. Canada currently prohibits oil-tanker traffic along most of its Western Coast, which could pose a problem to China. Finally, Chinese refineries are better suited for handling Middle-Eastern crude than Canadian crude. If China hopes to diversify its oil sources, this will have to change.

Cindy Hurst is a political-military research analyst with the Foreign Military Studies Office. She is also a Lieutenant Commander in the United States Navy Reserve. This article was adapted from a report for the Institute for the Analysis of Global Security www.iags.org. The views expressed in this report are those of the author and do not necessarily represent the official policy or position of the Department of the Army, Department of Defense, or the U.S. Government.